Evaluating Commodities, Business Cycles Vital to Good Credit Decisions

Credit professionals in industries that involve commodities should keep a close eye on a variety of factors—from the cost per bushel of corn to the value of the U.S. dollar to worldwide weather patterns—in order to secure themselves against the constantly fluctuating nature of these products.

This year, for instance, thanks to lower prices for many commodities, including corn and soy beans, Kevin Stinner, CCE, CCRA, credit manager with Crop Production Services, of Flora, IL, said he expects to see a sharp rise in bankruptcies among his customers. And as loans from traditional banks have not been as plentiful as they once were, more farmers will likely be asking for lines of credit

At about $3.50 per bushel in early 2017, corn is down roughly 50% of what it was three or four years ago he said. It's also at a price that is close to what it costs to produce the crop, meaning profits will likely be meager. Prices for soybeans, likewise, are down, as is the case for winter wheat. Combine low prices with a strong U.S. dollar, and worldwide demand for these U.S. staples—an increasingly important factor for domestic farmers—gets reduced and profitability fades as American products become more expensive in foreign markets, Stinner said.

Trade creditors to these farmers should pay attention to farming conditions, economic trends and other factors (rising oil costs, for example, means lower profits for corn producers) year-round in order to have a better sense of whether farmers will be able to repay loans due in the spring after getting paid for their crops in the fall. "I look at this information because as a creditor, in general it's a smart idea to know your customer's business," he said.

At Crop Production Services, credit professionals are trying to get ahead of this year's problem, in part, by taking out a lot more crop liens on customers, Stinner said. The process is timely and expensive, but the firm is looking to secure more of its receivables, especially for customers looking to extend their terms.

"We're looking at customers differently than in the past," he said. Before, there was more emphasis on the equity and straight financials of customers, whereas now credit professionals are factoring in overall profitability, whether customers can generate capital and if they have proper crop insurance.

A customer's character is also more important to consider than ever, Stinner said. During good times, such as from 2011 to 2013 when crop prices were at a peak, some farmers spent frivolously with windfall profits. Trade creditors should speak with previous creditors to see if their customers are financially responsible. Credit groups whose members utilize data in the National Trade Credit Report, as opposed to creditors asking for trade references, can speed up credit decisions, he said.

Also, from the credit department's perspective, given that a credit manager ponders risk versus return, credit professionals need to understand that a reduction in margins and sales volume from a customer due to commodity price fluctuations does not necessarily mean competitors are taking business away or undercutting prices, said Leonard Brown, CCE, CICP, senior regional credit manager with Ferguson Enterprises, Inc., of Orlando, FL.

Some businesses could react to such conditions by offering easier credit terms to combat what appears to be competition, when market conditions may be the deciding factor, he said. This misunderstanding may mean that the easier credit terms are not appropriate and could be detrimental. “The key is understanding the market and customer dynamics that are affecting sales volume and margins and taking the proper action,” Brown said.

– Nicholas Stern, editorial associate